

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
QUEENSTRAW, INC. :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and :
29 of the Tax Law for the Period March 1, 1989 :
through February 28, 1991. :

In the Matter of the Petition :
of :
ALBERT ERANI :
OFFICER OF QUEENSTRAW, INC. :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and :
29 of the Tax Law for the Period March 1, 1989 :
through February 28, 1991. :

DETERMINATION
DTA NOS. 812793,
812792 AND
812853

In the Matter of the Petition :
of :
ALAN ADES :
OFFICER OF QUEENSTRAW, INC. :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and :
29 of the Tax Law for the Period March 1, 1989 :
through February 28, 1991. :

Petitioner Queenstraw Inc., 71-24 Austin St., Forest Hills, New York 11375, filed a
petition for revision of a determination or for refund of sales and use taxes under Articles 28
and 29 of the Tax Law for the period March 1, 1989 through February 28, 1991.

Petitioners Albert Erani, Farm Road, Briarcliff Manor, New York 10510, and Alan Ades,
19 Heathcote Road, Scarsdale, New York 10583, each as officers of Queenstraw Inc., filed

petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1989 through February 28, 1991.

A hearing was held before Nigel G. Wright, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on March 8, 1995 at 10:45 A.M, with all briefs to be submitted by November 30, 1995, which date began the six-month period for the issuance of this determination. Petitioners appeared by Lester D. Janoff, Esq., and Jeffrey A. Baddish, CPA. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Robert J. Jarvis, Esq., of counsel).

ISSUE

Whether records from petitioner's¹ computer point-of-sale cash registers were not "source documents" and which for that reason are not acceptable for purposes of the record keeping requirements of the sales tax.

FINDINGS OF FACT

1(a). Petitioner Queenstraw, Inc. is a retail clothing store selling moderately priced women's casual clothing. It is located in Forest Hills, Queens and does business under the name of "Strawberry". It is part of a chain of 40 stores.

(b). Petitioner Alan Ades is president of Queenstraw and petitioner Albert Erani is its secretary-treasurer. Their responsibility as officers for the tax due from Queenstraw, Inc. has not been contested.

(c). Petitioner's stock is seasonal in nature. Its mark-up is typically about 100 per cent, but it has mark downs to prices as low as one-third of cost.

2(a). Petitioner has three cash registers. These are computer point-of-sale machines. Each register produces a single tape which is torn off and given to the customer, usually, by being stapled to a shopping bag. The sale is recorded internally in the machine. The machine cumulates subtotals and totals for net tax and for types of merchandise (showing discounts

¹When petitioner is referred to in the singular, the reference is to Queenstraw, Inc.

given) and also by type of transaction (e.g., cash, credit and layaway). All sales that are rung up on the register are recorded on the computer in the main office.

(b). At the end of the day the store manager "balances" the registers and summarizes the transactions on a consolidated tape. He makes a daily bank deposit of the cash. Credit card sales, which amount to about half of all sales, and layaways, presumably are handled later from the main office.

(c). At the end of the day the accumulated total of each category on the registers is transferred to the main computer. Any records from the cash register used by the store manager are discarded after a few days.

(d). The main computer tracks sales and calculates inventory. It is also a security system controlling "shrinkage" of inventory in each location and department. Petitioner's CPA found that he could trace a sale from inception right through to the general ledger.

3(a). The auditor (who was working closely with her supervisor) noted in her report that there were discrepancies between the sales tax returns, the gross sales records and the Federal income tax returns. This amounted to approximately \$13,000.00. However, this was explained later and the Division did not pursue this at the hearing.

(b). The auditor sent out an appointment letter, dated May 13, 1991, which included a request for books and records. It states in its second paragraph: "All books and records pertaining to your Sales and Use Tax Liability for the period under audit are to be available on the appointment date. This would include journals, ledgers, sales invoices . . . cash register tapes. . . ." The letter adds that "[d]uring . . . the audit [the taxpayer] may be required to furnish additional records and/or information." An attached sheet entitled "Records requested for sales tax audit" included: "6. Sales invoices - A" and "12 Guest checks and cash register tapes--as applicable-- A". The note "A" referred to above states, "for a test period to be mutually agreed upon." The record does not show that any test period was agreed upon. Another note stated "Additional information and records may be required."

(c). The audit report declares that petitioner's records were computerized.

(d). The auditor made a specific request for sales invoices and register tapes but found that petitioner did not keep such records. Petitioner offered certain computer records but these were rejected by the auditor because "source documents weren't available; there were no register tapes or sales invoices" The auditor made requests several times for "source documents" with which to do her audit. A source document she defined as "a document that originated from the transaction."

4(a). The auditor's computation of the tax due began with a list of prices from a random selection of items exhibited in the store. This was done for one day, September 13, 1991. There was no attempt to select items that reflected the proportion of items actually sold by the store. The prices recorded were those on the price tags, as reduced by any further mark down on that day. These prices were compared with costs computed from petitioner's books.

(b). The auditor sampled 31 items. Seven items were priced below \$10.00 and the remainder were \$10.00 and above and the median price was \$25.00. She grouped the items into profitable items and loss items. Loss items were 9.67% of total sales. She calculated a mark-up of 111.98% on the profitable items and a mark down of 67% on the loss items.

(c). In September the prices in the store are the highest of the year.

(d). The audit did not take into account "shrinkage". Petitioner has estimated its shrinkage as from 2.3% to 3.0% of inventory.

(e). Petitioner's own test of its overall markup was 88%. This test used a sample of actual sales made. The workpapers for this test are not in evidence.

5. The notice of determination in each case finds an amount due of \$19,396.00, plus interest and penalty. The amount due is composed of \$399.00 for use tax on fixtures and equipment, \$6,614.00 for unsubstantiated exempt sales and \$12,383.00 for unreported gross sales. The amounts determined for use tax and for unsubstantiated exempt sales were not contested at the hearing.

CONCLUSIONS OF LAW

A. I must find for petitioner. It appears to me to be incontestable that the computer records of petitioner were "source documents". While "source document" is not defined in the statute or the regulations the auditor's definition appears sensible enough: a document that originates from the questioned transaction. In this case all entries into the computer system originate simultaneously with the single entry on the cash register made at the time of the sales transaction. The fact that there was one tape which was discarded after it was used in connection with the daily cash bank deposit does not impair the validity of the information recorded in the machine or of any later printouts. Records tendered to the auditor should not have been rejected for this reason out-of-hand. While at this hearing no other issues were argued, I must point out that, generally, of course, computer records may be deficient in other ways, including ways peculiar to computers (see, 20 NYCRR 533.2(f)(4); Petition of Coren, Advisory Opinion, July 22, 1991 [TSB-A-91(50)S]). But, while the audit workpapers mention the existence of computerized records, apparently no computer assisted audit was made.

B. The Division attempts to raise another issue in its brief. That states that petitioners' Exhibit "1" in evidence "is apparently a summary of the store's sales for one day, and is not a document showing individually each 'sale. . .' as required by Tax Law § 1135(a)(1)." Apparently the argument is that sales records must show each sale separately recorded and records showing cumulative totals only are insufficient. I must find, however, that this issue was not properly raised or pursued. The answer of the Division puts in issue only that petitioner failed to maintain and make available adequate books and records from which a detailed audit could be conducted. An audit is said to be a "detailed" audit merely to distinguish it from a "test period" audit or a statistical audit (see, Audit Method Election, form AU-377.12, reprinted in 4 NY Tax Service § 121.84; Matter of Seiler Corp., State Tax Commission, September 13, 1985 [TSB-H-85(236)S]). In any event the term is not defined in the Tax Law or the regulations. At the hearing there was no questioning or discussion concerning any alleged "summary" nature of petitioner's records nor failure to produce individual sales figures. Indeed

the only argument at the hearing concerned whether petitioner's computer records were "source" records. In fact, while at the hearing, I did not realize that any other issue was involved in this case. At the present time I will not reopen the case for further evidence, in view of the Tribunal's policy of finality of our proceedings (see, Matter of A & J Auto Repairing Corp., Tax Appeals Tribunal, May 6, 1993). And more important, neither the transcript nor petitioner's brief reveals that petitioner had any awareness of any other issue. In view of this I must rule that any issue of summary records is not in this case. I am supported in this by a decision of the Tax Appeals Tribunal. In that decision the Tribunal stated that a general statement in an answer (and in an opening statement), in light of later specific and continued references to a single specific issue, did not put petitioners on notice of a different issue not mentioned. (Matter of Clark, Tax Appeals Tribunal, September 14, 1992; see also, Matter of Scarpulla v. State Tax Commn., 120 AD2d 842, 502 NYS2d 113, 114).

If the issue of separate records for each sale had been raised I would still have to rule for petitioner as a matter of fact. It is difficult to believe that petitioner had no separate records when half of its sales were credit card and lay-away sales. I can note that the extent of the burden of proof on the petitioner on this issue is only a preponderance of the evidence (Matter of King Crab Restaurant Inc. v. Chu 134 AD2d 51, 522 NYS2d 978).

C. The audit method was adequate only for a limited purpose. For instance, it did not attempt to reflect the actual proportion of items in inventory. It may have been adequate to indicate whether a more complete audit could be justified. In fact if it had been adequately shown that the books and records were not sufficient it might be fully acceptable. (Matter of Korba v. State Tax Commn., 84 AD2d 655, 444 NYS2d 312.) However, the results of this audit, rather than questioning petitioner's tax returns, in fact sustain them. The difference in sales found by the auditor is only 4.1% of reported gross sales. That is insignificant. The former State Tax Commission ruled in a case remarkably similar to the one in this case (Matter of Victor International, State Tax Commn., March 22, 1985 [TSB-H-85(127)S]), also involving a clothing store, that a difference of over 9% of gross sales had to be disregarded.

D. At the hearing an objection was made by petitioner to the introduction of the auditor's report. The Division argued that the report is a business record. I find that a tax agent's report alone is, generally, not admissible in evidence. It is certainly not a business record (Hartzog v. U.S., 217 F2d 706, 55-1 US Tax Cas ¶ 9218; Clark v. Commr., 266 F2d 698, 707; 59-1 US Tax Cas ¶ 9430; see also, Stevens v. Kirby 86 AD2d 391, 450 NYS 2d 607). However, it is clear that the Tax Appeals Tribunal will allow the audit report into evidence despite its hearsay nature (Matter of 3 Guys Electronics Inc., Tax Appeals Tribunal, September 9, 1988 [audit papers alone]; Matter of Lancaster Auto Collision, Tax Appeals Tribunal, September 7, 1995 [audit papers with testimony of supervisor]; Matter of Mira Oil Co. v. Chu, 114 AD2d 619, 494 NYS2d 458, lv denied 68 NY2d 602, 505 NYS2d 1026). The petitioner, if he wishes to cross-examine, is expected to subpoena the auditor (or at least request his presence). In any event, in this case, the auditor was present and did testify.

At the hearing the Division objected to petitioner's attempt to elicit information concerning the type of records kept by large department stores including Bloomingdale's. However, the objection must be denied. Evidence of other taxpayers would be pertinent under the Tribunal's ruling that our hearings may include issues concerning the selective enforcement of the Tax Law (Matter of Petro Enterprises, Inc., Tax Appeals Tribunal, September 19, 1991). It is clear, however, that the auditor did not have such information.

E. The petitions of Queenstraw, Inc., Albert Erani and Alan Ades are granted, the amounts in dispute (see Finding of Fact "5") are cancelled and the determinations are reduced to the amounts not in dispute.

DATED: Troy, New York
March 28, 1996

/s/ Nigel G. Wright
ADMINISTRATIVE LAW JUDGE